Home Office

CMA consultation on mobile radio network services market investigation draft order (the Consultation)

Home Office further response submission

Introduction

1. This submission follows the Home Office's early response submission, submitted on 8 June 2023 (the **Early Response**), which raised a number of issues and requested a number of clarifications in relation to the following matters in the Draft Order:

    a. the scope of the charge control, including whether it is confined to just three emergency services organisation customers under the specified contracts or applies to other users more widely;

    b. the CMA's guidance on the level of the charges for the Other Menu Services;

    c. the WACC estimate in the Final Report;

    d. indexation of the depreciation allowance; and

    e. a formula in the Charge control model.

2. The CMA confirmed on 12 June 2023 that it does not intend to provide further clarification in response to the Early Response ahead of the 16 June 2023 Consultation deadline. This second response submission (the **Further Response**) is therefore made without the benefit of any clarifications from the CMA in relation to the issues raised in the Early Response. This Further Response should be read together with the Early Response which, for ease of reference, is provided in Appendix 1 to this submission.[1]

3. Please note that the Home Office has provided further commentary in relation to the scope of the charge control (issue a.) at paragraph 45 and Appendix 3 below. Issues b. through to e. are not repeated in this submission.

[1] Unless otherwise specified, the defined terms used in the Early Response submission have been adopted for the purposes of this Further Response.

4. In this Further Response, the Home Office outlines additional comments that it has noted upon its review of the Draft Order and accompanying documents.[2] Briefly, the issues raised in this submission relate to the following matters:

   a. how Airwave Solutions (**Airwave**) forecasts charges;

   b. the timing of reconciliations;

   c. the final reconciliation amount;

   d. RAB indexation;

   e. the level of detail that must be provided in the opex and capex breakdown;

   f. the charges forecast; and

   g. other issues.

5. The Home Office's comments in relation to these issues are outlined in turn below. However, the Home Office has first set out its understanding of the CMA's proposed reconciliation mechanism in the Draft Order for the CMA's consideration and in the interests of clarification.

The CMA's proposed reconciliation mechanism

6. The Draft Order specifies how a maximum revenue for each year t of the charge control would be set ($RevMax(CPM)_t$).[3] Airwave is required to estimate this ex ante, i.e. before the start of year t, based on forecasts. Since forecasts often differ from actuals, the CMA allows for an NPV-neutral adjustment (from Airwave's perspective) for any discrepancies between the forecasted (and recovered) and the allowed revenue in the following year of the charge control ($Recon(CPM)_t$). This is consistent with the CMA's indication of the process in the Final Report.[4]

7. The adjustment is NPV-neutral to Airwave because the Draft Order allows Airwave to recover the allowed WACC plus inflation on any underpayment while paying the allowed WACC plus inflation on any overpayments.

8. The Home Office sees at least two sources of potential deviation of the recovered revenues from the allowed revenues:

   a. capex on external equipment differing from forecast levels; and

   b. outturn inflation differing from forecast inflation.

[2] In addition to the Draft Order, the Home Office has reviewed, and the Further Response responds to, the accompanying consultation documents: the 'Draft explanatory note', the 'Charge control model for Order – Draft' and the 'Notice of intention and public consultation'.
[3] Draft Order, Schedule 1, para. 1.
[4] Final Report, Appendix K, para. 67 (e).

How Airwave forecasts future charges – guidance to Airwave

9. The reconciliation adjustment under the Draft Order is NPV-neutral to Airwave. However, this will not be NPV-neutral from the perspective of the Home Office or other users of the Airwave network because it is based on Airwave's WACC rather than the WACC of these organisations. In other words, the Home Office and other Airwave users could lose, or possibly gain, when Airwave's outturns do not match the forecasts.

10. In addition, should outturns deviate materially from forecasts and result in major variations in charges, this would make it difficult for the Home Office (and likely other users) to budget effectively. As explained in the following section, government budgets are set before the financial year commences, and often several years in advance through multi-year Spending Reviews.[5]

11. HM Treasury expects the final full year spend for government departments to be [✂],[6] but under the Draft Order Airwave will only be required to report on any required reconciliations in October. Therefore, it is important to the Home Office (and, potentially, to other users of Airwave) that deviations of actual revenues from the allowed revenues are minimised to the extent possible.

12. In relation to capex on external equipment, the Home Office observes that the Draft Order requires Airwave to explain *any* discrepancies between the actual, allowed and planned capex.[7] This should encourage accurate forecasting by Airwave.

13. However, the Home Office urges the CMA to provide guidance to Airwave on how it should undertake inflation forecasts. For example, such official forecasts as those by the Office for Budget Responsibility (OBR) or Bank of England could be used.

The timing of reconciliations

14. The Home Office interprets the timeline set out in the Draft Order within which reconciliations to account for deviations between outturns and forecasts are to be made, and service credits applied, to be as follows:

    a. In year t-1, Airwave charges the Home Office and other users based on Airwave's forecasts (RevMax(CPM)_{t-1}).

    b. By 31 October of year t, Airwave has to provide a reconciliation adjustment calculation for the year t-1 (Recon(CPM)_{t-1}).[8] The reconciliation adjustment

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[5] For more detail, see HM Treasury (2011), 'Supply Estimates: a guidance manual', July, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/220744/estimates_manual_july2011.pdf.
[6] HM Treasury (2023), 'Consolidated Budgeting Guidance: 2023-24', March, p. 57, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1141848/CBG_2023-24_final.pdf.
[7] Draft Order, para. 6.2 (b).
[8] Draft Order, para. 6.3 (b), 6.3 (c), and 6.6.

calculation is to be based on Airwave's statutory accounts and actual inflation for year t-1.[9]

c. In the same year t, i.e. before 31 December, the payment or credit corresponding to the reconciliation adjustment has to be made.[10]

15. The Home Office would need to make a payment to Airwave if Airwave's actual revenue in year t-1 is lower than the allowed amount. The timeline described above implies that the payment would need to be made in November or December of year t, with notice only being provided after 31 October of that year.

16. Such a timeline provides (very) limited opportunity for the Home Office or the CMA to verify the reconciliation calculation provided by Airwave before the reconciliation payment falls due. The Home Office and CMA would potentially have [✂] if Airwave's reconciliation calculations are only provided on the 31 October, as the last invoice for the same calendar year is typically issued [✂].

17. Most importantly, the timeline would create practical challenges for the Home Office due to the specifics of its budgeting process, which reflect UK governmental budgeting requirements, which is described below.

a. The Home Office's financial year is from 1 April to 31 March.

b. Initial budget limits are set before the financial year commences, and typically several years in advance through multi-year Spending Reviews.[11] Internal allocations within the Spending Review limits are set [✂] before the financial year commences.

c. Each month, forecasts for the rest of the financial year are updated and the most important update is the '[✂]. The expectation of HM Treasury is that the actual spending for the year for each department, including the Home Office, does not deviate [✂].[12] This requires each part of the departmental budget to be forecast as accurately as possible [✂] deviations at the departmental level may lead to penalties or other remedial actions being imposed by HM Treasury.[13]

d. [✂].

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[9] Draft Order, para. 6.4.
[10] Based on the formula for RevMax(CPM)_t, which includes RevMax(CPM)_{t-1} as a component.
[11] For the definition of Spending Review, see HM Treasury (2011), 'Supply Estimates: a guidance manual', July, p. 116, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/220744/estimates_manual_july2011.pdf.
[12] See HM Treasury (2023), 'Consolidated Budgeting Guidance: 2023-24', March, p. 57, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1141848/CBG_2023-24_final.pdf.
[13] Ibid., para. 2.97.

18. Due to this budgeting process, the Home Office needs to know the final amount of Airwave charges for year t, including the amount of the reconciliation adjustment, by [✂] of year t, i.e. sufficiently in advance of [✂]. This is necessary to help ensure that the Home Office, as a whole, [✂].

19. [✂].

20. In reality, should Airwave identify that the Home Office would need to make a positive reconciliation amount to Airwave, the Home Office would need to [✂] The earlier this is identified, the less disruption this will cause to other activities within the Home Office.

21. To conclude, the Home Office acknowledges that the preparation of statutory accounts, estimation of the required reconciliation adjustment and obtaining independent assurance should be allowed sufficient time. However, [✂] for the Home Office to verify the reconciliation amount and find the required funds does not appear appropriate. In addition, the Home Office is required to provide an accurate forecast update in [✂] of each year, in advance of when Airwave is due to specify the final reconciliation amount, only due in October. This timing undermines the Home Office's ability to forecast accurately. In this context, the Home Office asks the CMA to bring forward the date Airwave is due to provide the reconciliation calculations and amounts to no later than [✂].[14]

The final reconciliation amount

22. In addition to the annual reconciliation process described above, there is a final reconciliation process at the end of the charge control, which serves the same purpose as the annual reconciliation process. The reconciliation of revenues in the final year of the charge control is referred to as the final reconciliation adjustment ($\text{Recon(CPM)}_{\text{FINAL}}$).

23. The Draft Order specifies two different ways of calculating the reconciliation adjustment in the final year ($\text{Recon(CPM)}_{\text{FINAL}}$), depending on whether the Airwave Network shutdown occurs before or after the end of 2029:[15]

    a. if the shutdown occurs before the end of 2029, no return and inflation indexation adjustment (ARet_t) is applied to the reconciliation amount;[16]

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[14] In the event that this is not practicable then, at the least, the Home Office would hope that the CMA directs that the provisional estimates be provided by [✂], with final amounts following by no later than [✂] of year t.

[15] Draft Order, Schedule 1, para. 12. The exact wording describing the period before the end of 2029 is 'through a calendar year between the start of 2024 and the end of 2029'.

[16] The following formula applies with no adjustments: $\text{Recon(CPM)}_{\text{FINAL}} = \text{RevMax(CPM)}_{\text{FINAL}} - \text{Rev(CPM)}_{\text{FINAL}}$.

b. if the shutdown occurs after the end of 2029, a return and inflation indexation adjustment ($ARet_t$) is applied.[17]

24. Such a specification has two implications that the Home Office considers to be inconsistent:

a. First, a difference in the shutdown date of one day (i.e. before or after the 'end of 2029') may result in a significant difference in the amount of the reconciliation adjustment.

b. Second, not applying an indexation adjustment (as the Draft Order specifies to be the case should shutdown occur before the end of 2029) is inconsistent with the Draft Order's approach to reconciliation in other years and would not be NPV-neutral.

For example, suppose the shutdown date arose in November 2029, Airwave will not be required to provide data on its actual 2029 costs until 2030,[18] and so the final reconciliation is unlikely to be settled in 2029.[19] In this context, if, for example, in 2028, Airwave forecasts a higher than needed cost sharing adjustment (CSA_t) for 2029, the reconciliation (to adjust for Airwave's over-recovery) will happen after 2029 but, according to the Draft Order, the amount that Airwave will need to pay back to the Home Office and other users will not be indexed to account for the additional return Airwave would have been able to earn on its overestimation of actual costs. As a result, the reconciliation adjustment will be insufficient and Airwave will over-recover its revenues in NPV terms.

25. The Home Office asks the CMA to ensure all reconciliation adjustments are NPV-neutral.

26. In addition, the Home Office asks the CMA to specify whether 31 December 2029 would be considered to be before or after the end of the year, i.e., to confirm the specific time and day for the year end for the methodology's purpose.

RAB indexation

27. In the Final Report, the CMA has specified that it intends to index RAB in the charge control. In particular, the CMA has made the following references:

a. *'Given that, the allowances for depreciation will be [✂] million per* year *in relation to the opening RAB, and [✂] million per year in relation [to] new capex, subject to the RAB indexation arrangements described in paragraphs 144 to 145.'*[20]

[17] The formula from Paragraph 1 applies, i.e. $Recon(CPM)_{2029} = (1 + ARet_{2030}) * [RevMax(CPM)_{2029} - Rev(CPM)_{2029}]$.
[18] Draft Order, para. 6.6.
[19] The same concern applies for any shutdown date before the end of 2029.
[20] Final Report, Appendix K, para. 141.

b. In the Provisional Decision Report (**PDR**), the CMA states the following: *'In order to provide for a real return consistent with this over the course of the charge control, we proposed that the RAB should be indexed to movements in CPIH from 2023 onwards.'* The CMA further adds in a footnote that: *'[…] this approach of applying a deflated WACC to an indexed asset value is commonly used as a means of providing for a return on capital in charge controls.'*[21]

c. *'We [the CMA] will consult on the precise way in which RAB* indexation *should be applied as part of the development of the Order implementing the remedies set out in this final report'*;[22]

d. *'Depreciation and return allowances would be adjusted to reflect the RAB being indexed to CPI from 2023'*.[23]

28. In the Draft Order, the CMA sets up the mechanics of the indexation for the first time. Those are summarised below.

a. Depreciation allowance will not be indexed by inflation and will instead be constant in nominal terms at [✂] million.[24]

b. RAB will be annually updated for capex and depreciation allowances but not inflation.[25]

c. Inflation will be added to WACC when estimating the allowed return, using the following formula: $ARet_t = [(1 + [0.061]) \times (CPI_t/CPI_{t-1})] - 1$, where 0.061 represents WACC, which will be updated in the Final Order.[26]

29. The CMA acknowledges in the explanatory note that the approach in the Draft Order differs from the approach outlined in the Final Report but states that it is simpler, broadly equivalent and overall consistent with the Final Report:

'A nominal percentage return on capital ($ARet_t$) should be calculated for each relevant year, and applied to the average nominal value of the RAB in that year. This differs in form from the indexation approach set out in the Report, which involved applying a fixed real percentage return on capital to the average real value of the RAB in the relevant year (ie it applied indexation to the RAB rather than to the percentage return on capital figure), ***but is simpler and to substantially equivalent effect. It is consistent with the decisions included in the Report.'***[27] [emphasis added]

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[21] Final Report, Appendix K, para. 142.
[22] Final Report, Appendix K, para. 147.
[23] Final Report, Appendix K, note to Table K.8.
[24] Draft Order, Schedule 1, para. 6.
[25] Draft Order, Schedule 1, para. 9. See the formula for the closing RAB value: $ClRAB_t = OpRAB_t + CA_t - DEP_t$.
[26] Draft Order, Schedule 1, paras 1 and 8.
[27] Explanatory note, para. 51 (e).

30. The Home Office has compared the two approaches and, although agrees that they result in broadly similar allowed revenue amounts, would like to offer the following comparison for the CMA's consideration.

31. The Home Office has used three inflation scenario assumptions to compare RAB indexation approaches:

    a. Scenario 1: Based on March 2023 OBR CPI inflation forecast;

    b. Scenario 2: Scenario 1 + 5pp;

    c. Scenario 3: Scenario 1 – 5pp.

32. The 5 percentage point deviations from the central forecast scenario are examples of an extreme rather than expected inflation deviation.

33. The RAB indexation approaches the Home Office compares are as follows:

    a. Approach A (Draft Order): is described above and is based on the CMA's draft Charge control model for Order;

    b. Approach B (Final Report): is specified by the Home Office with the intention to follow the principles in the Final Report as closely as possible. It is based on the methodology used by Ofwat in the PR19 price control and is outlined at Appendix 2 to this response.

34. Broadly speaking, under Approach B (Final Report):

    a. the opening RAB is annually indexed by inflation, with indexation starting in 2023;

    b. new capex is indexed by inflation the year after it is added to the RAB (note that due to the lag in timing, no double-counting of inflation is introduced even though capex inputs are nominal);

    c. depreciation of the indexation component (of both the opening RAB and new capex) is added to the depreciation allowance;

    d. the RAB base, which is multiplied by real WACC to estimate the return, is the average of the inflated opening RAB and the closing RAB.

35. The table below outlines the results of our analysis. The table shows that the sums of depreciation and return allowances are relatively similar for the two approaches across inflation scenarios.

Table 1 Depreciation and return allowances under Draft Order and Final Report inflation indexation approaches

£m	Scenario 1: OBR	Scenario 2: + 5pp	Scenario 3: - 5pp

Approach A (Draft Order)			
Depreciation	[✂]	[✂]	[✂]
Return	[✂][1]	[✂]	[✂]
Total under Approach A	**[✂]**	**[✂]**	**[✂]**
Approach B (Final Report)			
Depreciation	[✂]	[✂]	[✂]
Return	[✂]	[✂]	[✂]
Total under Approach B	**[✂]**	**[✂]**	**[✂]**
Difference (total A – total B)	**[✂]**	**[✂]**	**[✂]**
Difference (total A – total B) as % of revenue under Approach A	**[✂]**	**[✂]**	**[✂]**

Note: estimated for seven years of the charge control without pro-rating 2023. [1] The Home Office has corrected a formula error in the CMA's charge control model to estimate the return allowance. The correction is explained in the Early Response (see section 'A formula in the charge control model').

36. However, the two approaches imply different inflation risk profiles: for example, under Approach A (Draft Order), Airwave rather than the Home Office bears the inflation risk on the depreciation part of the allowance. In addition, Approach A is novel and technically does not involve RAB inflation indexation as the CMA's Final Report suggested. Therefore, the Home Office respectfully requests that the CMA gives further consideration to whether the approach it proposed in the Draft Order is sufficiently consistent with the approach it proposed in the Final Report.

Specifying the level of detail that must be provided in the opex and capex breakdown

37. Airwave and Motorola Solutions are required 'to provide to the Home Office and the CMA the Statutory Accounts of Airwave Solutions for each relevant year, including a detailed breakdown of the levels of opex and capex shown in those accounts'.[28] However, the level of detail in the Statutory Accounts is insufficient to understand any cost drivers. Therefore, the Home Office considers that alternative wording, highlighting that the detailed breakdown is required *in*

[28] Draft Order, para. 6.4.

addition to the Statutory Accounts rather than *included* in the Statutory Accounts, would be more appropriate.

38. Furthermore, the level of detail that Airwave must provide is not specified. The Home Office asks the CMA to specify the requirements more precisely to ensure sufficient detail is provided to enable the Home Office and the CMA to assess the sources of any deviations of the actual costs from the forecasts. For example, the CMA could request the same level of detail as it used for setting the charge control charges. These breakdowns will be particularly useful in the context of the charge control review in 2026. This applies to both capex and opex.

Forecasts of future charges

39. The Draft Order requires Airwave to provide the Home Office and the CMA information necessary to demonstrate how the level of allowed revenue under the charge control has been calculated for each year.[29] Given the interaction between Other Menu Services and Core Services and Police Menu Services charges, this will require Airwave to provide the CMA and the Home Office detail on charges for all Specified Goods and Services.

40. The Draft Order does not specify the detail or frequency at which Airwave must forecast its charges. However, to comply with budgeting requirements imposed by HM Treasury, to be able to approve invoices raised by Airwave when they come in, and to be able to fulfil its responsibility for the Full Business Case of ESMCP (which includes Airwave), relatively detailed and frequent forecasts are necessary.

41. In particular:

    a. Budget limits for government departments are typically set several years in advance through multi-year Spending Reviews. The last Spending Review (SR21) required budgets to be set [✂] in advance. Between Spending Reviews, the Home Office's internal processes also require forecasts to be provided [✂] ahead as part of Medium Term Financial Plans. Therefore, the Home Office needs to have Airwave's calculation of the allowed revenue at least [✂] ahead of the year for which the revenue is calculated – e.g. the forecasts provided in 2023 need to go out to [✂]. These can be updated as Airwave gains more visibility of the expected charges.

    b. Forecasts until the end of the life of the charge control (currently December 2029) would also be useful to the Home Office, as whole life cost estimates are required to be captured and regularly updated in the ESMCP Full Business Case. Forecasting charges until the end of the charge control, and providing updates, would be a common way for a regulated business to manage its finances, and so is not expected to be incremental to how Airwave would otherwise run its business.

[29] Draft Order, Schedule 1, para. 6.3.

c. The Home Office's financial year is from 1 April to 31 March, while the charge control is set based on calendar years from 1 January to 31 December. To be able to reconcile the annual estimates of the allowed revenue with the Home Office's financial years, the Home Office requires the forecast to be provided at least on a quarterly basis.

d. In addition, to verify invoices, which Airwave raises [✂] forecasts would be required, noting that this level of detail was provided in accordance with the Blue Light Contracts Umbrella CCN2 (UCCN2) (the last contract agreed with the Home Office).

42. Most importantly, the Home Office and other users of the Airwave network need a breakdown of the charges forecast by (Blue Light) organisation and by invoice.

43. For example, [✂]. The Home Office has prepared an illustrative template that the Airwave could use to populate with the breakdowns (see tab "[✂]" in the Excel workbook provided with this response at Appendix 4 titled "Home Office Further Response - Appendix 4 – Charges Forecast Breakdown: Suggested Template").[30] Please note that the Home Office has prepared this analysis on the basis of its best knowledge and belief as to how relevant charges fall to be categorised.

44. To be able to verify invoices as they come in, the Home Office and other users of the Airwave network would also require a forecast of the breakdown of the charges by invoice. In the past, Airwave has provided the breakdown specified in the tab "[✂]" of the Excel workbook at Appendix 4. This was included as part of the UCCN2 agreement. If Airwave were to adopt a different invoicing structure going forward, a different breakdown of forecast charges would suffice, so long as it mirrored the way in which Airwave intended to charge.

Further comments in relation to the scope of the charge control

45. In further support of its comments outlined in paragraphs 4 to 10 of the Early Response (see Appendix 1), the Home Office would like to draw the CMA's attention to a number of paragraphs in the Final Report which support the Home Office's interpretation of the intended scope of the charge control, in particular that is not restricted to just the three emergency services organisation customers under the specified contracts. These paragraphs, as well as the Home Office's interpretation of them, are set out in Appendix 3.

[30] In the template, the Home Office asks for some 2022 information – this is to compare the Home Office's and Airwave's data on actual charges, to ensure it is clear to the Home Office, which charges Airwave refers to.

Other drafting comments

46. The Home Office has noted the following drafting irregularities or inconsistencies in the Draft Order that it encourages the CMA to consider and correct as appropriate.

47. The terms 'Airwave Network' and 'Statutory Accounts' are sometimes capitalised in the Draft Order but are not defined.

48. Motorola Solutions is defined as Motorola Solutions, Inc. The Order does not specify whether this definition includes all Group Companies and affiliated entities and therefore clarification is requested. If it is intended that the Order applies to subsidiaries/affiliates of Motorola Solutions, the Home Office suggests that the addition of the following wording may help to clarify: "*This Order applies to any subsidiaries and affiliates of Motorola Solutions that supply, or may during the life of the charge control supply, the Specified Goods and Services*".

49. The Draft Order allows Airwave, Motorola Solutions and the Home Office to agree alternative arrangements to those specified in the Order, as long as they 'do not result in a material weakening of the constraints' that the CMA has put on Airwave.[31] The Home Office requests that the CMA specify whether other Airwave network users are also allowed to agree alternative arrangements with Airwave.

50. Paragraph 1 of Schedule 1 uses CPI_t and CPI_{t-1} but these terms are not defined within this paragraph. A reference to the definition of CPI_t included in the later paragraph 7 would be helpful. It would also be useful to have clarity as to whether this definition in paragraph 7 of Schedule 1 applies as a base to all CPI-related figures i.e. CPI_{t-1} and CPI_{2021} in addition to CPIt. The same comment applies to RPI notations.

51. The term DEP is missing a subscript t (to be read as DEP_t) in Paragraph 6 of Schedule 1.

52. Article 5 identifies that Schedule 1 specifies the charge control methodology, but does not does not refer to the final settlement allowance calculation formula in paragraph 12 of that Schedule. The Home Office considers that a reference to the final settlement should be included in Article 5.

53. Paragraph 6.2 (b) of the Draft Order requires Airwave and Motorola Solutions to explain any '[m]aterial deviations between actual capex levels and: (i) those that were included in their capex plans […]'. The Home Office asks the CMA to specify which plans the CMA refers to (i.e. the plans that Motorola has submitted to the CMA to date, the plans underlying annual capex forecasts or other plans).

[31] Draft Order, para. 10.1.

16 June 2023

Appendix 1

Early Response

Home Office

CMA consultation on mobile radio network services market investigation draft order (the Consultation)

Home Office early response submission

Introduction

1. The Home Office welcomes the CMA's Final Report[1] and its well-reasoned decision to correct or mitigate the adverse effects on competition and impose a charge control, saving the Home Office and Great Britain's emergency services and, ultimately, UK taxpayers a significant amount of money.[2]

2. The Home Office is also grateful for the opportunity to review and comment on the Draft Order before it is finalised. The Home Office is currently reviewing the Draft Order in detail and will submit a full response to the Consultation setting out all of its observations before the deadline on 16 June 2023. [3] In the meantime, the Home Office would like to ask the CMA for clarification on a number of matters and highlight a few potential inconsistencies between the Final Report and / or the Draft Order and / or the materials accompanying the Draft Order. If possible, and to the extent that the CMA considers this necessary or prudent to ensure all responses to the Consultation can be as full and informed as possible, the Home Office would be grateful for clarification from the CMA on these points ahead of the deadline on 16 June 2023, so that the Home Office may accurately reflect the correct position in its substantive response to the CMA's consultation.

3. The queries on which the Home Office is looking for clarity from the CMA are in relation to the following matters:

    a. the scope of the charge control;

[1] CMA, Mobile radio network services, Final Report, 5 April 2023, published 13 April 2023: Final report (publishing.service.gov.uk), Appendices (publishing.service.gov.uk) and Glossary (publishing.service.gov.uk).
[2] The Home Office does, however, observe that, in the exercise of its discretion, the CMA has made a number of valuable concessions in Motorola's favour between its preliminary findings in the Provisional Decision Report and the CMA's Final Report, which the Home Office estimates amount to approximately £260 million over the life of the control (once indexation has been taken into account).
[3] In addition to the Draft Order, the Home Office is reviewing, and intends to respond to, the accompanying consultation documents: the 'Draft explanatory note', the 'Charge control model for Order – Draft' and the 'Notice of intention and public consultation'.

b. the CMA's guidance on the level of the charges for the Other Menu Services;

c. the WACC estimate in the Final Report;

d. indexation of the depreciation allowance; and

e. a formula in the Charge control model.

We discuss these in turn below.

The scope of the charge control

4. The Home Office's understanding of the CMA's intention as expressed in the Final Report is that:

   a. the revenue cap will cover the revenue earned from all goods and services provided by all of Airwave Solutions' business lines, to all customers, save only for those business lines and goods and services that are specifically excluded and listed in paragraph 8.20(b) of the Final Report;

   b. the focus of the charge control is on Core Services and Police Menu Services; and

   c. the charging arrangements for services forming the Other Menu Services will not be affected by the charge control remedy, as these services are affected by volumes; but

   d. the revenues for these Other Menu Services will nonetheless be estimated for the purpose of assessing the maximum level of revenue that would be recoverable each year based on a 2022 revenue estimate, uplifted each year of the control by an indexation factor being the weighted average of the percentage increase to the level of charges for Other Menu Services between 2022 and each year of the control[4]; and

   e. this would have the effect, should Airwave increase the actual charges for Other Menu Services, of increasing the weighted average described in (d), thus reducing the allowable revenue for Core Services and Police Menu Services, thereby creating an indirect constraint on the Other Menu Services' charges, even if these charges are not themselves capped, i.e. the mechanism restrains Airwave Solutions from seeking to recoup its lost profit on Core Services and Police Menu Services, from the Other Menu Services; but

[4] The Home Office notes that the CMA's position has altered slightly from that set out in the Final Report, Appendix K, paragraph 67(b), in that the CMA had previously indicated the increase would be related to the allowable contractual inflation adjustment for the charges for the services concerned.

f. the methodology avoids any unintended consequences of directly controlling the charges for Other Menu Services.[5]

5. However, Specified Goods and Services, the allowed revenue for which is restricted under the charge control, are defined in the Draft Order as follows:

'[…] the goods and services provided by all the business lines of Airwave Solutions to the police, fire and rescue, and ambulance services (or any of them) pursuant to all or any of the PFI Agreement, the Police Service Contracts, the Ambulance and Scottish Ambulance Contracts and the Firelink Project Agreement (in each case as amended), with the exception of: […]'.[6]

6. This definition suggests to the Home Office that:

a. the charge control's effect is limited to the goods and services provided by Airwave Solutions, by its business lines, to the three blue-light emergency services only, and only under the contracts listed within the definition (which is a significant change from the CMA's stated intention in paragraph 8.20(b) of the Final Report); and

b. any other goods and services and any other customers are removed from the scope of the control, whether direct or indirect, including the Home Office.

7. As the CMA will be aware, in addition to the police, fire and rescue and ambulance services, there is a long list of emergency service organisations that have been approved by Ofcom to access the Airwave network and its services.[7] These organisations are associated with the police, fire and rescue, and ambulance services, but are independent from these services and many have their own contracts with Airwave Solutions beyond the contracts listed in the draft definition of Specified Goods and Services. These organisations suffer the same (if not greater) asymmetry of bargaining power and information as the police, fire and rescue, and ambulance services, and it is the Home Office's understanding that the CMA's financial analysis of Airwave Solutions that found supernormal profits included the costs and revenues associated with all services provided, including to these organisations. Nevertheless, the Home Office's interpretation of the definition outlined above is that the effect of the charge control does not extend to these organisations.

8. The Home Office therefore requests that the CMA clarify the scope of the charge control (including, to the extent necessary, the addition of clarificatory wording in the Draft Order). In particular, the Home Office asks the CMA to confirm that its intention is that the definition of Specified Goods and Services covers services provided to all contracted users of the Airwave network,[8]

[5] See Final Report, Appendix K, paragraph 65.
[6] Draft Order, Article 2.1.
[7] See Ofcom (2023), 'List of Sharer Organisations (Updated February 2023)', and for the process of approval, see: Ofcom 'Airwave Sharers List Process'.
[8] With the exception of those that have been specifically excluded in (a) to (e) of the definition of Specified Goods and Services.

including all Sharer Organisations, and that the contracts listed in the definition are not intended to be exhaustive.

9. Assuming that the CMA did not intend to limit the scope of the charge control as described above, ideally, the definition of Specified Goods and Services in the Draft Order would be amended; the Home Office's suggested amendments are as follows:

> "***Specified Goods and Services*** *means the goods and services provided by all the business lines of Airwave Solutions to ~~the police, fire and rescue, and ambulance services (or any of them)~~ any and all of Airwave Solutions' customers, current or future ~~pursuant to all or any of the PFI Agreement, the Police Service Contracts, the Ambulance and Scottish Ambulance Contracts and the Firelink Project Agreement (in each case as amended),~~ with the exception of:*
>
> *(a) goods or services currently provided pursuant to Ambulance Bundle 2;*
> *(b) goods or services currently provided, or goods or services provided in future, by the Pronto business line;*
> *(c) goods or services currently provided, or goods or services provided in future, by the Command Central Control Room Solution (CCCRS) business line;*
> *(d) radio terminals (except where part of a managed service); and*
> (e) *services that are associated with the development and provision of any interface solution required for interworking and provided under the Interface Agreement.*"

10. Further, if (contrary to the Home Office's understanding of the CMA's Final Report) it is the CMA's intention to limit the scope of the charge control to just those Airwave network services supplied to the three emergency services, under the listed contracts, the definition as currently drafted does not include reference to the Home Office, nor the Department of Health or the Scottish Government, which are the organisations that contract with Airwave for the provision of certain services and which are responsible for payment for these services. The Home Office would therefore suggest the CMA consider the addition of some clarificatory wording to ensure that services provided to these organisations (for the benefit of the emergency services) are covered; for example, the addition of the words shown in red text:

> "*'[…] the goods and services provided by all the business lines of Airwave Solutions to the police, fire and rescue, and ambulance services (or any of them and which, for the avoidance of doubt, includes goods and services provided to the Home Office, Department of Health and or the Scottish Government on behalf of any of the police, fire and rescue, and ambulance services)[…]'*".

The charges and estimated revenue for the Other Menu Services

11. In relation to Other Menu Services, the Draft Order explains that the estimated revenue from Other Menu Services (ER(MO)t) would be based on the 2022

actual level of such revenue[9] and an indexation factor (IF(MO)t).[10] The Home Office would appreciate the CMA's confirmation that the principle applies only to the estimated revenue from Other Menu Services, i.e. it is not related to the actual charges that Airwave Solutions can set for Other Menu Services.

12. Related to this, the Home Office requests that the CMA confirm whether the indexation factor calculation, i.e. the reasonable estimate of the percentage increases that Airwave Solutions has applied to the level of charges for Other Menu Services between 2022 and year t, is limited to increases in charges only, and therefore will not be impacted by increases in volumes. Clarification is also requested as to whether the term “charges” refers to total charges or charges per unit.

13. The Home Office also considers that it is currently unclear in the Draft Order as to how the indexation factor (IF(MO)t) is to be calculated. The Home Office suggests that some clarificatory wording is provided, for example explaining how the “reasonable estimate” is to be determined or, alternatively and if necessary, that a formula for this calculation is added to the Draft Order.

14. Finally, the Draft Order does not specify how the actual charges for the Other Menu Services are to be set by Airwave and whether they are restricted in any way. The Home Office acknowledges that the explanatory note specifies that the charge for the Other Menu Services will continue to be subject to existing contractual arrangements,[11] and would appreciate clarity from the CMA on whether Airwave are restricted in setting new charges if existing contracts expire.

Indexation of the depreciation allowance

15. According to the Draft Order, no inflation indexation is applied to the depreciation component of the allowed revenue (DEP_t).[12] However, there is a note in the Charge control model for Order that suggests otherwise. In particular, cell L10 in tab ‘Updated_values_after_indexation’ states ‘CPI Indexation from 2023’.

16. The Home Office kindly asks the CMA to confirm whether its intention is to index the depreciation component of the allowed revenue by CPI or not?

The WACC estimate in the Final Report

17. The Final Report specifies a CPI-real pre-tax WACC estimate of 6.1% (being the upper end of the real pre-tax WACC range).[13] However, as set out in the following table, the Home Office estimates that using the CMA's individual

[9] £[✂]million, see draft Order, Schedule 1, paragraph 5.
[10] Draft Order, Schedule 1, paragraph 5 and the Draft explanatory note, para. 51 (b).
[11] Explanatory note, para. 12.
[12] Draft Order, Schedule 1, paragraph 6. Please note that ‘Allowed Revenue’ is capitalised as if it is a defined term within the Draft Order, but there does not appear to be an accompanying definition for this term. The CMA may therefore wish to consider making this term lowercase.
[13] Which will be updated prior to publication of the Final Order using index-linked gilt yields for the period from 1 December 2022 to 31 May 2023. See Draft Order, Schedule 1, paragraph 1, footnote 1.

WACC parameters specified in the Final Report, the WACC should be 5.9%. The Home Office therefore asks the CMA to check its estimate of 6.1% is correct?

Parameter	Formula[1]	CMA Final Report[2]	Reconciliation
Risk-free rate (CPI-real)	A	0.7%	0.7%
Equity beta	B	0.55	0.55
TMR	C	7.50%	7.50%
CPI inflaiton	D	3%	3%
Gearing	E	0%	0%
Tax rate	F	25%	25%
Ke post-tax (CPI-real)	G = A+B*(C-A)	n/a	4.4%[4]
Ke pre-tax (CPI-real)	H = G/(1-F)	n/a	5.9%[4]
WACC pre-tax (CPI-real)	I = Kd pre-tax*E+H*(1-E)	**6.1%[3]**	**5.9%[4]**

Source: [1] CMA Final Report, Appendix J, para 13. [2] Ibid., Table J-6. [3] Ibid., para. 95 (a). [4] Home Office analysis, based on CMA's parameters and formulas.

A formula in the charge control model

18. The Home Office observes that to be consistent with the Draft Order, a formula in the Charge control model for Order needs to be amended. [✂.]

TLT LLP

8 June 2023

Appendix 2

RAB indexation – Approach B

			2023	2024	2025	2026	2027	2028	2029
Mid-year inflation (OBR)	%	A[1]	6.1%	0.9%	0.1%	0.5%	1.6%	1.6%	1.6%
Years of charge control remaining	#	B	7	6	5	4	3	2	1
Residual RAB	£m	C[2]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Opening RAB b/f	£m	D	[✂][2]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Indexation on Opening RAB	£m	E=A*D	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Depreciation of Opening RAB	£m	F=(D+E-C)/B	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Opening RAB c/f	£m	G=D+E-F	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Average Opening RAB	**£m**	**H=AVG(D+E,G)**	**[✂]**	**[✂]**	**[✂]**	**[✂]**	**[✂]**	**[✂]**	**[✂]**
New CAPEX b/f	£m	I = O_{t-1}	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Indexation	£m	J=I*A	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
New CAPEX additions	£m	K[3]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Depreciation of new CAPEX (smoothed, unindexed)	£m	L=(sum of all K)/7	38	38	38	38	38	38	38
Depreciation of indexation (individual years)	£m	M=J/B	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Depreciation of indexation (cumulative)	£m	N=rolling sum of M	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
New CAPEX c/f	£m	O=I+J+K-L-N	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Average new CAPEX	**£m**	**P=AVG(I+J,O)**	**[✂]**	**[✂]**	**[✂]**	**[✂]**	**[✂]**	**[✂]**	**[✂]**
WACC	%	Q[4]	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%
Allowed return (Opening RAB)	£m	R=H*Q	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Allowed return (New CAPEX)	£m	S=P*Q	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Allowed return (Working capital)	£m	T=[✂][5]*Q	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total allowed return	**£m**	**U=R+S+T**	**[✂]**	**[✂]**	**[✂]**	**[✂]**	**[✂]**	**[✂]**	**[✂]**
Depreciation allowance	**£m**	**V=F+L+N**	**[✂]**	**[✂]**	**[✂]**	**[✂]**	**[✂]**	**[✂]**	**[✂]**
Allowed return and depreciation allowance	**£m**	**W=U+V**	**[✂]**	**[✂]**	**[✂]**	**[✂]**	**[✂]**	**[✂]**	**[✂]**

Note: b/f – brought forward, c/f – carried forward. [1] OBR (2023), 'Economic and fiscal outlook', March, p. 144. Corresponds to scenario 1 from the main text of the response. [2] Final report, Appendix K, para. 137. [3] Final report, Appendix K, Table K.7. [4] Final report, Appendix K, para. 147. [5] Final report, Appendix K, para. 142.

Appendix 3

Scope – Relevant Extracts from the Final Report

Relevant extracts from the CMA's Final Report:

Summary

- At paragraph 36, in respect of the proposed charge control remedy, the CMA comments:

  "*It will, in our judgement, mitigate the detrimental effects on customers (the emergency services and ultimately taxpayers) from Airwave Solutions' and Motorola's market power.*"

  The Home Office considers this to be a reference to all customers, with the reference to the "emergency services" in brackets not being limited to police, ambulance or fire & rescue services, but to all organisations who use Airwave, such organisations necessarily needing to be involved in public safety to be a user, and such that the comment does not limit the scope of customers to whom the charge control should apply, as the detrimental effects of the AEC are not limited to just police, ambulance and fire & rescue customers.

Remedies (Section 8)

- At paragraph 8.1(a) the CMA comments:

  "*The primary remedy is a charge control to remedy, mitigate or prevent the principal detrimental effect resulting from the AEC we have identified on customers, namely Airwave Solutions' (and its owner, Motorola's) ability to price above levels we would expect to prevail in a competitive market (the 'charge control remedy').*"

  The Home Office considers that as the CMA has not defined "customers" to limit the term to a specific sub-group of customers, the described purpose of the remedy applies to all customers.

- At paragraph 8.20 the CMA comments:

  "*We have decided that a charge control will be introduced to remedy, mitigate or prevent the detrimental effect on customers of the AEC we have identified, namely Airwave Solutions pricing above competitive levels.*"

  As for paragraph 8.1(a).

- At paragraph 8.20(b) the CMA comments, the charge control will:

"*…apply to the products and services provided by all Airwave Solutions' business lines, with the exception of: Ambulance Bundle 2; Pronto; the Central Control Room Solution (CCCRS); radio terminals (except where part of a managed service); and services associated with the development and provision of any interface solution required for interworking.*"

As for paragraph 8.1(a) the Home Office considers that this text does not limit the customers to whom the charge control remedy applies, rather it limits the scope of services covered by the remedy to exclude those specific services listed. The Home Office notes that nowhere else in paragraph 8.20 does the CMA state or otherwise indicate a limitation of the remedy to a subset of customers, referring only to customers, e.g., paragraph 8.20(g) in respect of the cost sharing mechanism. See also paragraph 8.62(a) which is similarly worded.

- At paragraph 8.23 the CMA comments:

  "*The charge control remedy will limit what Airwave Solutions is allowed to charge its customers for those services included within the scope of the control. While the charge control does not address the underlying cause of the AEC we have identified, it will remedy, mitigate or prevent the customer detriment resulting from that AEC.*"

  The Home Office observes that this sentence does not limit the scope of the remedy to a specific subset of customers, referring only to customers generally.

- At paragraph 8.25 the CMA comments:

  "*More detailed submissions concerned with how a charge control might be applied and calibrated are considered in Appendix K…*

  …Submissions related to the effectiveness and proportionality of the charge control remedy are assessed in paragraphs 8.126 to 8.174."

  This text may suggest additional consideration and detail that may impose a scope limitation in Appendix K, which the Home Office considers further below.

- At paragraph 8.65 the CMA comments:

  "*The charge control remedy constrains the levels of revenue that Airwave Solutions will be allowed to recover from Airwave Network services.*"

  The Home Office considers that this sentence does not indicate a restraint in scope of customers to whom the remedy applies, including not indicating any restriction to a sub-set of customers.

- At paragraph 8.130 the CMA comments:

  "*For example, until ESN (or an alternative network), or competitive arrangements, replaces the Airwave Network it will continue to be provided by a single supplier* *and the Home Office will be dependent on it for critical services without alternative options.*"

While this sentence suggests that the Home Office will, absent ESN, be dependent on the Airwave Network, it is clear that the same is true for all users of the network, and the Home Office therefore does consider that this sentence indicates any restriction of scope of customer.

- At paragraph 8.137 the CMA comments:

  "*The charge control remedy will not address the underlying cause of the AEC we have identified, but it will remedy, mitigate or prevent the customer detriment arising from it. In particular, it will mitigate the detrimental effect on customers of Airwave Solutions pricing above competitive levels. It will do this by directly limiting the amounts that Airwave Solutions is allowed to charge its customers for Airwave Network services, in the specific ways set out in Appendix K. Not imposing that remedy would, in the absence of effective alternatives, mean that the substantial customer detriment resulting from the AEC would remain unaddressed.*"

  The Home Office considers that this paragraph again does not suggest a limitation of the scope of the remedy to only a sub-set of customers, rather it suggests a need and resulting purpose for the control to cover all customers harmed by the AEC.

- At paragraphs 8.145 to 8.149, which explain the timescales over which the remedy will take effect, the CMA again only refers to customers generally, and not to a sub-set of customers.

- At paragraph 8.159 the CMA comments:

  "*A key part of mitigating the detrimental effects is limiting Airwave Solutions' ability to price above levels we would expect in a competitive market. In line with the comments in paragraphs 8.136 to 8.152 above, we consider that the charge control remedy will be effective in achieving this aim. We set out our assessment of how an appropriate price level can be established in Appendix K, and the charge control remedy will limit the prices that can be charged for Airwave Network services accordingly.*"

  The Home Office considers that this paragraph does not restrict the remedy to certain customers, rather is makes the point that the charge control will mitigate the detrimental effects by limiting the price above levels expected for a competitive market, i.e., it is not restricting the market to a sub-set of customers in the market who would benefit.

- At paragraph 8.164 the CMA comments:

  "*Our decision to impose the charge control remedy is the result of that assessment. As set out above, our view is that a charge control is required to* *remedy, mitigate or prevent the detriment to customers that would otherwise be expected to result from Airwave Solutions' / Motorola's unilateral market power, given the absence of credible alternatives.*"

The Home Office observes that this paragraph again refers only to customers, and not to a sub-set of customers.

- At paragraph 8.168 the CMA comments:

  "*The Home Office, as the key customer of the Airwave Network and the government department responsible for procuring the replacement network, should be in a position to address the AEC we have identified at source by 2029…*"

  This paragraph clearly indicates the CMA view of the status of the Home Office as a key Airwave customer. However, the Home Office considers that it does not limit the scope of the remedy to a subset of customers or to just the Home Office.

- At paragraph 8.176(a) the CMA comments:

  "*A charge control to remedy, mitigate or prevent the principal detrimental effect on customers of the AEC we have identified, namely Airwave Solutions' (and its owner, Motorola's) ability to price above levels we would expect in a competitive market.*"

  The Home Office observes that again this sentence refers to customers, and not to a subset of customers.

Appendix K

Introduction and summary

- The introduction and summary section, including *Figure K.1: Summary of conclusion on charge control design,* does not refer to customers other than in respect of the cost sharing mechanism. The Home Office observes that this reference is general and does not in any way indicate the remedy's mechanism should apply only to a sub-set of customers.

Charge control design issues

- In this section, the CMA does not discuss restricting the customers to whom the charge control will benefit.

- In the "*How the control will be applied to changes for different network services*" (from paragraph 59), the CMA explains its provisional decision position and that charges for non-core services "*should be set at their then prevailing levels under the current arrangements*" (para 59(a)(I)), that volume dependent services should use a forecast (para 59(a)(II)), that the estimated revenue should be deducted from the level of allowed revenue for 2023 (or part thereof) to determine the level of allowed revenue to be recovered from core charges (para 59(a)(III) and (IV), and charges for all core services should be reduced by the fixed percentage amount required to align the revenue that would recovered from those charges with allowed revenue to be recovered from charges for core services (para 59(a)(IV). However, the Home Office observes that within this provisional assessment there was no restriction of the remedy to certain customers.

- At paragraph 62 the CMA noted:

  "Motorola submitted that the proposed approach in the PDR could give rise to complaints about discriminatory treatment of sharers and users who rely to a larger extent on menu and catalogue services."

  The Home Office observes that this is the first point in the Final Report and Appendix K that the possibility of different treatment of customers in the charge control remedy was raised.

- The Home Office's position, as stated by the CMA in paragraph 63, was that:

  "*The Home Office said that the proposal to cap total allowed revenue but allow Airwave Solutions to keep non-core charges at prevailing levels would mean that different purchasers would cross-subsidise each other, with Airwave Solutions able to earn more than required for non-core services but less than required for core services. The Home Office said that a simple, proportionate adjustment to core and non-core charges to achieve the target reduction in overall revenue would avoid cross-subsidisation while still allowing Airwave Solutions to earn the same revenue. The Home Office said that its preferred approach would be to keep the current volume-dependency arrangements for those non-core charges that are currently volume dependent, but that there should be no asymmetry between the treatment of increases and decreases in required volumes (with the Home Office having referred to such an asymmetry under the current arrangements.*"

  However, at no point did the Home Office indicate or suggest that the charge control should not cover all customers, indeed the Home Office is concerned that all customers should be protected from the pricing effects of the AEC.

- In paragraph 64 the CMA's assessment was that:

  "*Having considered the submissions on this matter, and reviewed relevant evidence further, our conclusion is that the charge control should be applied such that the effect of its introduction and ongoing operation is focused on core and police menu services only. These services accounted for almost [✂]% of Airwave Solutions revenue in 2021 included within the scope of the charge control.*"

  The Home Office observes that the CMA's assessment does not result in the exclusion of a sub-set of customers from the control altogether, rather that there is a focus on certain specific customers.

- In paragraph 65 the CMA went on to explain:

  "*We note that the Home Office and Motorola submitted that it would be more appropriate to apply a fixed percentage adjustment to the charges for all of the services within the charge control. However, as we noted in the PDR, Motorola identified revenue associated with the Police Traffic Unit, the Amber Light Contracts and Catalogue/Growth sales (which together accounted for around [✂]% relevant revenue in 2020) as being affected by relevant volumes. We have decided that the charge control should not require adjustments to the charges for these services given the risk of unintended consequences arising if such an approach were to be adopted. In line with our comments in the PDR, we consider there to be a risk that required reductions in the charges for these services (e.g. as a consequence of applying of the approach preferred by Motorola and the Home Office) may result in a misalignment between Airwave Solutions' costs for the provision of such services, and the revenues it is allowed to collect. For some services, such an approach could potentially generate undesirable incentive effects associated with their provision, in particular, if the additional revenue fell short of relevant incremental costs.*"

- The CMA continues to explain its rationale in paragraph 66:

  "*In our view, given the focus of investigation on the Airwave Network, and over the overall profitability of Airwave Solutions in its provision of Airwave Network services, we are not well placed to judge the likely materiality of these risks, other than in relation to police menu services for which Motorola identified revenues as not volume-related (other than in terms of the network coverage decisions police forces make). In particular, we note that Police Traffic Unit, the Amber Light Contracts and Catalogue/Growth sales relate to a relatively long list of additional services that are made available to different users, and we have not considered it necessary or proportionate to assess the detailed charging arrangements that apply to all of these additional services as part of our investigation*."

- As a result, at paragraph 67 the CMA confirmed that:

  "*In line with the above, we have concluded that the charge control will be applied in the following way:*

  (a) *The charging arrangements for Police Traffic Unit, the Amber Light Contracts and Catalogue/Growth services <u>will not be affected by the charge control remedy</u>.* [Emphasis added].

  (b) An estimate of expected revenue from Police Traffic Unit, the Amber Light Contracts and Catalogue/Growth services will be calculated for each charge control year by applying the contractual inflation adjustments relevant to those services to Motorola's forecast of revenue from those services in 2022 (£[✂]million). We note that Motorola has forecast that revenue from these services will remain unchanged through to 2026, other than as a result of

indexation. We will consider evidence on whether this estimate should be updated (on a forward-looking basis) at the 2026 charge control review.

(c) The estimate of expected revenue from Police Traffic Unit, the Amber Light Contracts and Catalogue/Growth services calculated under (b) will be deducted from the Allowed Revenue figure for the relevant year to determine the Allowed Core + Police Menu Revenue.

(d) A fixed percentage adjustment will be applied to charges for core and police menu services in order to align the revenue to be earned from those services with the Allowed Core + Police Menu Revenue calculated under (c).

(e) The precise level of Allowed Revenue (and therefore Allowed Core + Police Menu Revenue) to be applied each year will only be known ex post, as it will depend on indexation adjustments and the operation of the cost sharing mechanism. In line with our proposal in the PDR, we have decided that Airwave Solutions will be required to set charges on the basis of its best estimate of the level of allowed revenue that would apply to the relevant year, and for there to be a mechanism through which the financial effect of differences between the estimated allowed revenue used to set charges and the finalised allowed revenue (after indexation and cost sharing adjustments have been made) can be adjusted for in an NPV neutral way.

(f) The Order implementing the remedies set out in this final report will specify detailed provisions to implement the steps outlined in paragraphs (a) to (e)."

The Home Office considers that the effect of this decision is that while the remedy will not directly limit the revenue that Airwave may earn from these services, or otherwise directly control the charges that may be levied for the services, should Airwave charge more for these services than is allowed by the methodology, the amount of revenue that Airwave is allowed to recover from other services is reduced, thereby indirectly restraining the pricing for these services.

Appendix 4

Charges Forecast Breakdown: Suggested Template

[See excel workbook provided with this response]